

## LUCELEC's Fuel Price Hedging Programme

LUCELEC began a fuel price hedging programme in June 2009 in a move aimed at stabilising the price that the Company pays for fuel and thereby reduce the volatility of the price of electricity to its customers. Today's column explains what this programme involves, the reasons behind it, and the impact on customers and their electricity bills.

### What is Fuel Price Hedging?

Hedging is used to reduce risks, from events or activities that a company or person may have little or no control over. This usually involves negotiating a contract between two parties that achieves that purpose using various methods. In this case, a price for fuel over a period of time is negotiated and regardless of changes in the price of oil the user pays the agreed price.

### Why is LUCELEC engaging in Fuel Price Hedging?

LUCELEC buys fuel at market prices approximately every 2 days and this is passed through at no mark up to the customer via the fuel surcharge mechanism. As oil prices are outside LUCELEC's control, this means that the surcharge fluctuates constantly. The Company is engaging in fuel price hedging by contracting to pay a fixed price for fuel in the future and so reduce the constant monthly fluctuations in the fuel surcharge and thereby in customers' bills.

Few would forget the record oil prices in July 2008 which saw the fuel surcharge reach their highest levels ever. This was then followed by sharp reductions which resulted in large tariff reductions. Hedging helps to smooth out these frequent changes in the price customers pay for electricity, thereby helping to make expenditure on electricity a little easier to predict and assists domestic and business customers to manage their finances better.

### How does the programme work?

The programme began with a pilot phase in 2009 during which time the Company obtained a better understanding of the hedging process and was able to evaluate its level of exposure to the risks associated with hedging. This was largely successful and a fully fledged hedging programme was started in January 2010.

LUCELEC's Board established a Fuel Risk Management Committee to manage all hedge activities and to use only Fixed Price Swaps to hedge its fuel price. Fixed Price Swaps allows the Company to pay the fixed price for fuel over periods of about 3 months to 12 months regardless of the market price. This price is determined after taking several factors into consideration including the strategic objectives of the programme, current fuel prices, projected prices and trends, and the Company's risk appetite, among others. This allows the Company to minimise, to some extent, the frequent fuel price fluctuations.

Generally LUCELEC hedges on a quarterly basis, up to an allowed maximum of 75% of its fuel requirements for the period. That is, the Company ensures that at least one quarter is fully hedged, though it may hedge

smaller amounts for future periods. The Company pays its supplier (HESS Oil St. Lucia Ltd.) at the market rates and the difference between that market price and the hedged price is settled between LUCELEC and the company that it has entered the hedge contract with. The average fuel price used in the calculation of the fuel surcharge is computed on the fixed price (the hedged price) and passed through to customers.

### **Hedge Results to Date**

To date the programme has provided a certain measure of stability and reduced volatility for customers. Keeping in mind that 25% of LUCELEC's fuel volumes are not hedged (in accordance with prudent practice) and by the nature of any fuel hedging programme there cannot be any guarantee that absolute elimination of volatility is possible.

As usual, if you have any comments or questions associated with this article or about LUCELEC in general, please feel free to contact LUCELEC via email to [connected@lucelec.com](mailto:connected@lucelec.com) [1] or by calling 457-4400. You can also visit our website at [www.lucelec.com](http://www.lucelec.com) [2] for additional information or pick up a fuel price hedging programme brochure at one of our offices.

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